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MONEY MANAGER INTERVIEW

BOBBY EDGERTON

Capital Investment Companies

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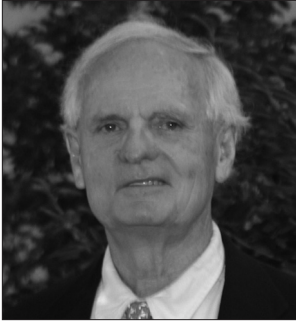
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Long-Term Value Investing

BOBBY EDGERTON, CAPITAL INVESTMENT COMPANIES



BOBBY EDGERTON is a Co-Founder of the Capital Investment Companies in Raleigh, N.C., and since 1984 he has served as an Executive Officer and Principal of the companies. He is also the firm's Chief Investment Officer and has been in the financial services industry since 1979. Mr. Edgerton graduated from Wake Forest University with a B.A. in business and finance.

SECTOR — GENERAL INVESTING

(ACW504) **TWST: Please begin with an introduction to Capital Investment Companies.**

Mr. Edgerton: Capital Investment Companies is really two businesses. My partner, Richard Bryant, and I founded the company in 1983 as a money management company. It has since evolved into what you might call one part in many Merrill Lynch, which is Capital Investment Group, run by Richard and Ben Brooks. That part of the business sells annuities and mutual funds, and all the things that broker/dealers sell. My end of the business is asset management, where people primarily own their own stocks and have say so in what goes on, which is very important to me. For example, many clients may own a bunch of **Costco** (COST) stock — and a lot of them do, actually — and really like it, and have no desire to sell it. Well, if they're in a mutual fund, the manager might have to sell it internally if he wants, because maybe it is too much of the portfolio. That's not the case here. And so I'm strictly a stock market manager. My clients own their own stocks, pretty much the same stocks that I buy for myself. I got registered with the SEC in 1970, and Richard and I merged the businesses in 1983, so we are pushing 27 years now.

TWST: Please tell us a little bit about your investment philosophy.

Mr. Edgerton: I graduated from Wake Forest as a finance major, where I got all the basics. In my late 20s, I started following the stock market, and I got interested. I started reading *Value Line*, *The New York Times*, *The Wall Street Transcript*, *Financial Times*, *Forbes* and *Barron's* from cover to cover. I got

more and more fascinated with it. I realized how many times Wall Street gets things wrong about stocks — selling what they ought to be buying, and buying what they should be selling. And I saw the enormous fluctuations in stocks. One year, maybe a **C.R. Bard** (BCR) back in the day would trade between \$35 and \$10; I knew the company didn't fluctuate that much. My philosophy is that if you buy and do your homework — compute the market value of a company, relate that to their assets and their earning power — then in many cases, the stock price is so much less than what the company's worth. That's how my philosophy evolved. I like companies that have a lot of cash and no debt. I tell clients that

come in, if you wanted to coach basketball, and you went to work for John Wooden for a couple of years, and Mike Krzyzewski for a couple of years, and Dean Smith for a couple of years, you'd

Highlights

Bobby Edgerton shares his investing strategies and provides in-depth examples of his experience. His philosophy — built on what he believes may be the largest filing of news clips on the world's great companies — is to take advantage of the mistakes other investors make, finding value where others miss it. Mr. Edgerton creates tailored portfolios for clients, investing for them what he invests in himself.

Companies include: Costco Wholesale Corporation (COST); C.R. Bard (BCR); Exxon Mobil Corp. (XOM); FedEx Corp. (FDX); United Parcel Service (UPS); Royal Dutch Shell plc (RDS-A); Johnson & Johnson (JNJ); The Coca-Cola Company (KO); Google (GOOG); Apple (AAPL); Adobe Systems (ADBE); Newmont Mining Corp. (NEM); Barrick Gold Corp. (ABX); Eldorado Gold Corp. (EGO); Expeditors International of Washington (EXPD); Gap (GPS); Hewlett-Packard (HPQ); Wal-Mart Stores (WMT); Paychex (PAYX); Automatic Data Processing (ADP); Whole Foods Market (WFM); Cracker Barrel Old Country Store (CBRL); Wells Fargo & Company (WFC); Lincoln National Corp. (LNC); Bank of America (BAC); Juniper Networks (JNPR); Lowe's Companies (LOW) and New Oriental Education & Technology Group (EDU).

probably know what you were doing.

Well, I got the same thing reading Bob Barro in *Barron's* for all those years, and now Tom Donlan; reading Vermont Royster in *The Wall Street Journal*. These guys were pros and had been around forever. I felt like I'd learned from the masters, just like a coach would from Wooden and Dean Smith. I put Richard Holman, the Founder of *The Wall Street Transcript*, on that list. He was an organizational genius the way he went about it. If you're a client at Merrill Lynch, all you've got is Merrill Lynch's research. Richard Holman would get four experts in the field of chemicals, for example, and you'd get a much broader perspective. Then he interviewed money managers. So using all those great publications, including *Value Line*, that's how I taught myself.

“We enjoy our independence. Like I say, I’m not going to have some bank tell me that I need to increase my derivative business when I can’t stand all that stuff in the first place. So we treasure our independence, and we do our best to look after our clients first and ourselves second.”

My confidence grew over the years. Today, I like companies that have great finances first. Then I look at all the real estate, the cash flow, everything I can look at. Of course, the essence of the stock market for people who are not pros is that every one of these companies has two values. Number one is precisely what the stock market values a company at, and that's down to the penny. But what's the company really worth? Obviously, the market says that **Exxon** (XOM) is worth \$350 billion. Well, I think their oil reserves are probably half to two-thirds of that. Then you've got their properties worldwide. You're calibrating what the stock market says the company's worth compared to what they are really worth. Now, you can never put exact figure on what they're really worth, but in many cases, it's pretty glaring when the stock is down so low that it's a bargain. And if you are patient, you'll make money over the long haul. That's essentially my philosophy.

TWST: Would you tell us a little bit about your research process and then how you go about picking stocks?

Mr. Edgerton: I hope I have this encyclopedic knowledge by now of the world's best companies. I guess the core encyclopedic part of that would be *Value Line*, which is in my opinion, the best at what they do. It's a stock market encyclopedia. So if somebody wants to teach themselves and know about companies, that's where you'd go. Then if you want to get more specific about industries, you go to *The Wall Street Transcript*. And then what I'll do is every week, I will scan every *Investor's Business Daily*, every *Forbes*, every *Barron's*, every *Financial Times*. I do it the old fashioned way. If there is a great article on **Royal Dutch** (RDS-A), where they nail what's going on, I cut it out. I just pull it out and file it away in my filing cabinet. It's very non-high-tech, but I like it when

I think a publication gets to the core of what a company is all about. It could also be a CNBC interview.

So I have what I might call the largest filing cabinet of articles on great companies, maybe in the world. I guess that might be true. I like to meet the person who would contest that. The world is filled with mediocre to bad companies, and there is also a select group of unbelievable companies — the **FedExes** (FDX), the **UPSes** (UPS), the **Exxons**, the **Costcos** of this world. The interesting thing is relating what you've got to what you want. A lot of people put sell points on stocks, but what makes me sell a stock is not so much what that company is doing. If I've got one or two or three companies that are way undervalued relative to what I own, that's what makes me sell.

TWST: You've talked recently about avoiding “merger acquisition lure” of the financial services industry in recent years. How does being independent differentiate your firm from others?

Mr. Edgerton: My partner Richard Bryant and I are both pretty individualistic guys. We're not going to work for anybody. We're not going to have people tell us what we need to push on the public to make money. Being independent is wonderful. All these people think they've got to merge to compete. That is so far off track. I mean, you can stay small, and if you've got a large cash horde and no debt, you can stay alive.

You don't have to be huge. We enjoy our independence. Like I say, I'm not going to have some bank tell me that I need to increase my derivative business when I can't stand all that stuff in the first place. So we treasure our independence, and we do our best to look after our clients first and ourselves second.

1-Year Daily Chart of Exxon Mobil Corp.



Chart provided by www.BigCharts.com

TWST: You've said that you tailor each portfolio, if you will, to the individual investor.

Mr. Edgerton: That's right. I have this philosophy that there is no problem a great stock portfolio can't solve. If you ever need money and you've got a slug of **Exxon**, a slug of **FedEx** and a lot of great companies — they're going to raise their dividends over the years. The cash flow is there whenever you need it. And the stock fluctuates so much. I never guarantee anything in the stock market except one thing: these stocks are going to fluctuate.

You take right now, **Johnson & Johnson** (JNJ) and **Coca-Cola** (KO) are both \$66. I can guarantee they're not going to stay the same price. That's not the way the world works. But when you get these stocks, it's like basketball, a game of runs.

"I'm a big tech investor. I love following the battles between Google (GOOG) and Apple (AAPL) and Adobe (ADBE), and all these fabulous companies. I'm attracted not only to the talent, but because it's just the way the world is going. They're so cash rich."

Let's say I have a bunch of **Costco**, and it's running up to \$84 now; and let's say **Coca-Cola** goes down to \$60. So **Coke** is at the low for the year, and **Costco** is at the high for the year. Well, I can sell 1,000 **Costco** at \$84, and buy 1,000 **Coke**, and I haven't hurt the portfolio. That's \$24,000 difference that goes out of the distribution. It's not a product. People for some reason like products. Well, I don't. The stock market is so much like sports. If you could publicly trade NCAA football teams, I'm going to buy Southern Cal seven or eight years ago, before Pete Carroll got there and they went five and six, and everybody dropped the stock. Then when Southern Cal won the national championship two years in a row, and it's way up, while Miami and Florida State are just having horrible years. And that's when I'd sell me Southern Cal football stock into Florida State, Miami and maybe LSU has a bad year. The same thing happens to companies. It's all very cyclical.

TWST: What are some of the broader themes you're focusing on right now?

Mr. Edgerton: I'm a big tech investor. I love following the battles between **Google** (GOOG) and **Apple** (AAPL) and **Adobe** (ADBE), and all these fabulous companies. I'm attracted not only to the talent, but because it's just the way the world is going. They're so cash rich. I mean, as we speak, the last balance sheet for **Apple** was \$76 billion in cash and no debt. They increased their balance sheet cash by \$10 billion in one quarter; that's pretty amazing. So I don't know if I have themes or not. I just take what the market gives me.

I think owning gold stocks, which have lagged, makes a lot of sense due to all the problems that governments and institutions are having now. And obviously, I don't think people disagree very much: there's just too much currency being printed. So gold gets more and more viable. You've got **Newmont** (NEM), **Barrick** (ABX), **Eldorado** (EGO), all these really good gold companies that have large gold reserves and large cash hordes, and they really haven't gone up. As Larry Fink, the BlackRock CEO, said that these stocks are priced like gold, like \$600 an ounce instead of \$1,800 an ounce. I agree. I'm not scared to concentrate the portfolios. I think mutual funds and index funds are going to just lag good managers forever because they're so structured. They don't want one company to comprise maybe

more than 3% or 4% or 5% of portfolio.

Well, **Apple** is pushing 60% of some of our plans now, and that's because adjusted for splits, my cost basis in **Apple** is \$9. Now, will I ever diversify and sell it? I don't know. **Apple's** just kind of like part of the family now. Occasionally, a great company or two just gets out of favor in the stock market. Now, would I go to 20% for somebody with **Coca-Cola** or **Exxon**? Maybe, if they're comfortable with that. I think you get your biggest returns when you get an opportunity and a great company gets blasted in the stock market, and it's so cheap, you should buy a substantial amount of shares in it.

TWST: Would you share some of your best ideas or stories at the moment?

Mr. Edgerton: If I had to pick the best company that most people have never heard of, it would be **Expeditors** (EXPD). **Expeditors** is really the king of moving goods around the world — jeans for the **Gap** (GPS), laptops for **Hewlett-Packard** (HPQ), **Apple** products. They don't own any trucks, planes or anything like that, but they do the packaging. They've got \$1.2 billion in cash, no debt. They own all of their real estate and they're run by what I call a Mike Krzyzewski-type guy named Peter Rose, who has just been a phenomenal CEO. When 2008 was so bad, he didn't lay off his people to get his bottom line up. He doesn't fall for that junk. He kept his people, and one reason he kept his people was because they had so much cash. That's how you build loyalty, that's how you build a culture, which is what Steve Jobs did.

1-Year Daily Chart of Expeditors International of Washington



Chart provided by www.BigCharts.com

It's the same thing with Jim Sinegal at **Costco**. He looks after his employees a lot better, in my opinion, than **Wal-Mart** (WMT). **Costco** has made **Wal-Mart** a lot better company. But that's a typical company, as is **Paychex** (PAYX), as is **ADP** (ADP). I'd say there are 40 or 50 companies there in a league of their own. I keep saying that they create a culture — like **Whole Foods** (WFM) has — that's build a following, the loyalty. Those are the kinds of companies that I like. If you put that common denominator of a cash-rich, debt-free stock selling at the low for the year and a great company — and then you've got to sprinkle that patience on top of that — that will probably make you a lot of money over the

years. More importantly, it will not lose you much money.

TWST: Is there a unified theme as to why the companies you like are disrespected or undervalued, or is it more company specific?

Mr. Edgerton: To be honest with you, so many people who participate in this business aren't very bright. They're doing the wrong things. They want computer programs to pick their stocks. They pay no attention to the person who is running the company, which is absolutely vital. That's one thing I think that *Barron's* taught me.

“I occasionally hear that long-term investing is dead, and that’s ridiculous. The people who make the most money in real estate are the people who have held the real estate the longest time. The people who, by and large, have held great companies for the longest time make the most money.”

Alan Abelson, who writes the “Up and Down Wall Street” column, was so critical of Wall Street people over the years, and I've learned to see why. At the least sign of a down quarter, they bail on stocks and they oversell them. They did that with **Cracker Barrel** (CBRL), which is a great company. When we had 9/11, the country froze, and **Cracker Barrel** went down to \$10 a share with 50 million shares outstanding. That's a \$500 million market cap. Well, they own around 432 locations at about \$2.5 million a piece. That's \$1.2 billion in real estate, and the market's only valuing the company at \$500 million. The stock went from \$10 to \$40. That's what I'm talking about: relating the market value to what the real value is, and what it will be four or five years from now. It's kind of like Jim Cramer. Cramer is probably the biggest celebrity of Wall Street now, and he eats and sleeps the stock market. But he tries to explain every day in the stock market, which you can't do. And in many cases, when the stock market goes down, he gets bearish, and when it goes back up, he gets bullish. To me, that's backwards.

TWST: We hear a lot of talk about a “new reality.” Do you feel like, in this post-recession world, investing has changed? What does that mean for investors these days?

Mr. Edgerton: I occasionally hear that long-term investing is dead, and that's ridiculous. The people who make the most money in real estate are the people who have held the real estate the longest time. The people who, by and large, have held great companies for the longest time make the most money. Obviously, you've got to stay on top of the situation. **Roadway** was my classic company. Back in 1981, they were run by a man named Spitznagel, and Galen Roush. Well, when those guys retired, the leaders kind of caved in to the unions. They ran up their debt, and the stock is \$0.06 now. It's really being turned around by a guy named James Welch now.

Look at **Wachovia**. Down here in North Carolina,

Wachovia was an icon. John Medlin was the CEO. He hired Bud Baker, and Bud Baker sold out to Ed Crutchfield at **First Union**, which was a lot more leveraged bank, and the rest is history. All the people in North Carolina that relied on their **Wachovia** dividends, they lost them. It's now **Wells Fargo** (WFC). For every five shares of **Wachovia**, you used to have one share of **Wells Fargo**. And sadly, that **Wachovia** name is gone.

There was a great company in North Carolina, **Jefferson Pilot**, which had a great reputation in insurance business, and no debt, run by a guy named Roger Soles. They now have \$5 billion in debt. They merged with **Lincoln National** (LNC), and so the **Jefferson Pilot** name is gone. That's like giving up the Boston Celtics' name, or the New York Yankees' name. So there have been a lot of bad news leaders in the last 15 or 20 years. When **Merrill Lynch** has to be bailed out, **Bank of America** (BAC) has to be bailed out by the government, it's ridiculous. It was lousy leaders who leveraged the company and had borrowed bunch of money. Banking is probably the most profitable business in the world in the good times, but if you're leveraged and your loans go bad and you get deflation, that can wreck banks. And that's a lot of

our root problem right now. The banks are still in such bad shape with their real estate loans and all the things they do, that's what's really dragged the economy of the country down. It's too bad there wasn't one major bank that stayed debt free. I told my partner Richard Bryant when we formed the business that we would not borrow any money, ever. And that's how we operate.

1-Year Daily Chart of Juniper Networks



Chart provided by www.BigCharts.com

TWST: How do you incorporate risk management into your style?

Mr. Edgerton: My starting point is cash to market value. It's not true of everything, but I look at a company like **Juniper Networks** (JNPR), which has been hammered down. I see the market value is maybe \$9 billion, and they've got over \$4 billion in cash. That's pretty good. You take **Apple** right now. **Apple** has \$900 million shares outstanding, and the stock is \$400. So the market value of the company is exactly \$360 billion. Well, they have got \$80 billion in cash. That's a pretty good percentage of the market value. And then you figure what's that **Apple** name worth?

I think *Fortune* did an interview about brand names, and I think they valued the **Coke** brand name as about \$65 billion. I think **Apple's** run by **Coke** in brand name value.

I look at the amount of real estate you own. Everybody doesn't like **Lowe's** (LOW) stock right now, but **Lowe's** owns 88% of locations. So you've got a \$20 stock that has probably \$13 in real estate and equipment. You add up the corporate assets: the real estate, the cash flow, the cash; and then the intangibles, such as the kind of people that are involved in running a company. You know, it's just like sports, you get the wild card. In athletics, it's injuries. Nobody can predict those. If you lose your best players during the season, you're just about toast. So it's going to be absolutely fascinating what happens to **Apple** without Steve Jobs. And everybody has got their own opinion. But I think they've laid down an ecosystem where when you have got something like 92% of the S&P500 are on iPads now — it's going to be tough to unseat them.

TWST: What are two or three of the best reasons for a long-term investor to look closely at your firm?

Mr. Edgerton: It's cocky statement, but I just think that I outworked everybody. I think I know more about more different stocks than anybody else. I would like to meet the guy who wants to compete with me. I know that's a cocky statement. But I think you come to Capital because Bobby Edgerton looks after you and not him. He buys you the same stocks he buys himself, and explains to you when you lay out a portfolio, what you're buying and why. That's now how some mutual fund guy would work. I will throw in one last stock: **New Oriental** (EDU), which is the educational leader in China, which has a fascinating corporate history. The market value is \$4 billion; the symbol is **EDU**.

The Chinese are absolutely fanatics on education. These kids, even before they go to college, study 16 hours a day. If you look at the growth that **EDU** has had, and they've beaten down lately, it's about a \$26 stock with \$4 billion market cap. The last balance sheet that I pulled up, it had \$282 million in cash and no debt. The CEO was just interviewed on "Fast Money," and it was

fascinating. He made the observation that all the people who go to his universities pay out of their pocket. He said, "You know in China, you can have one child. So you've really got six adults saving to educate one child." You've got two sets of grandparents, plus a husband and wife, and they are all saving money so that he can get educated. So that's a \$26 stock. And if you went around to the average stockbroker or money manager and asked him who **New Oriental** is, I bet you 95% have never heard of it.

TWST: Is there anything else you would like to add?

Mr. Edgerton: I just would close by saying that here again, with people worried about where to put their money, I'd be little apprehensive in putting my money in any bank. That may sound radical. Do you know what they're going to do with your money? Of course not. Money market funds are kind of sketchy to say the least now — where they have to go, the paper they have to buy to get any kind of return at these low rates. But stocks — these companies like **Costco** have been run just as good as our government has been run bad. They don't run deficits, they run huge surpluses. So if you really pin me down and somebody came to me and said, "I want to put my money where I feel safe and I can sleep at night," well, a portfolio of the world's best companies gets that done. You've got to be able to put up with the ups and downs of the stock market, but you are investing in the companies. You are not buying the stock so much, you're buying the company. And that's what I try to get my clients to understand.

TWST: Thank you. (MJW)

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